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SUBJECT: EC OPTIMISTIC ON UKRAINIAN GAS PIPELINE COMMITMENTS

Ref: Brussels 436

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Summary

¶11. (SBU) On March 31 European Commission External Relations (RELEX) Energy Counselor Faouzin Bensarsa told us that President Yushchenko and PM Tymoshenko remain on message following the March 23 investment conference on Ukraine's gas transit system (reftel). Bensara, who was in Kyiv to discuss the next steps outlined in the conference declaration, said Yushchenko and Tymoshenko continued to demonstrate a shared commitment to the package of reforms Ukraine agreed to in the declaration. A joint EC/GOU/donors coordination unit was being created to implement the technical aspects of the declaration, he said. The EC would not support Ukraine's desire to construct an additional 60 billion cubic meters (bcm) of transit capacity, since the planned technical upgrades and efficiency measures could increase existing capacity by at least 30 bcm within seven years, he said. It also saw no need to install metering stations at the Ukrainian border with Russia. He characterized the Russian reactions to the conference as "emotional" and said the EC would work to ensure that the planned cooperation with Ukraine would not disrupt the Ukraine/Russia gas relationship. Bensara asked for active USG engagement to move the planned modernization of the pipeline system forward. End summary.

President, PM Continue to Show Unity on Pipeline

¶12. (SBU) On March 31 the DG RELEX Energy Counselor Faouzin Bensarsa and local Commission officials briefed us on their follow-up discussions with Ukrainian officials aimed at implementing the March 23 EU/Ukraine declaration (reftel). Bensara, who met with both President Yushchenko and PM Tymoshenko while in Kyiv, said he saw a strong and shared Ukrainian commitment to the package of reforms foreseen in the declaration. In particular, he said there was no difference of opinion between President Yushchenko and Prime Minister Tymoshenko on the need for reform of the GTS.

¶13. (SBU) Bensara stressed that the Commission would limit its work to the goals outlined in the March 23 declaration. It would avoid discussions on contentious issues such as privatization or the question of the creation of a consortium to run the pipeline. He did not offer any views on the issue of "unbundling," and said that the EC has stopped using the expression "commercialization" in reference to alternative models of managing the pipeline, but did emphasize that Ukraine was on track to take the steps necessary to join the European Energy Committee. The timetables listed in the

declaration -- the development of a gas sector reform program by the end of 2009 with implementation in 2010-2011 -- were realistic and would not change, he said. Bensara stated that Deputy Prime Minister Hryhoriy Nemyria would take the lead on implementing the needed reforms, with support from Deputy Foreign Minister Constantin Yeleseyev, the Ministry of Energy, and the Presidential Secretariat.

14. (SBU) Bensara said a coordination unit with representatives from the GOU, the EC and from donors would be established to implement the technical aspects of the declaration. The Commission was prepared to offer technical and financial support to the unit. The EC hopes that banks interested in financing projects related to reforms will begin their due diligence, but Bensara was not sure whether they would do so before reforms had been set in motion. Acting Director of Naftohaz Igor Didenko would be POC for the technical implementation of the master plan of proposed technical upgrades to the GTS that Naftohaz presented at the Brussels conference. Bensara characterized the master plan as a shopping list of projects from which the banks (and other investors if interested) could choose. He said the first meeting of the technical coordination unit could be held within the next few weeks.

No Interest in Pipeline Expansion, Metering Stations

15. (SBU) Bensara was careful to note, however, that the Commission would not actively support two projects put forth by the GOU because they are, in the Commission's view, politically sensitive. The Commission would not push forward the Ukrainian suggestion to install gas meters at its eastern border with Russia, since the

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Commission believed that they would not make sense economically unless/until European clients of Gazprom begin to purchase gas from the Russia/Ukraine border instead of from the Ukraine/Slovak border.

Bensara also believed that the GOU suggestion to increase the GTS capacity by 60 bcm through the construction of new pipelines was overly ambitious. The Commission would focus on efforts aimed at expanding the efficiency of the existing network, he said. If implemented, the seven year modernization plan would increase the capacity of the existing pipeline system by at least 25 percent through a combination of technical upgrades and efficiency measures.

Russia

16. (SBU) Bensara said Japan has shown serious interest in the GTS modernization project, but did not say how the Japanese might get engaged. At the same time, he characterized the Russian reaction to the declaration as "emotional." He also noted that the Commission was working to correct what he said was Russia's misunderstanding of the declaration. He did show concern, however, over Russia's next moves, and asked if Russia had lobbied the USG in any way on the issue of the GTS modernization and the Brussels conference. He also said the Commission would work to ensure that the cooperation with Ukraine on the GTS would not disrupt the implementation of the 10 year gas contract signed by Gazprom and Naftohaz in January.

Comment

17. (SBU) It is encouraging that Bensara received a coordinated and unified message from President Yushchenko and Prime Minister Tymoshenko on the way forward for Ukraine's GTS. Experience has taught us to be cautious, however, since signs of unity displayed before an international audience can quickly be forgotten once the President and Prime Minister return to the business of domestic politics. Still, the EC focus on what it believes are pragmatic technical and regulatory steps to modernize the pipeline could allow it to sidestep the politics that have made genuine reform so difficult to achieve in Ukraine. Bensara openly asked for USG engagement. We do not know whether he spoke formally in the name of the EC. However, if Brussels proposes formal collaboration, we

would consider this a valuable avenue for achieving our overarching goal of helping Ukraine strengthen energy security as we committed in our bilateral Charter.

TAYLOR